

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE MAFUBE LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Mafube Local Municipality (municipality) which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126 of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis of accounting**

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

**Basis for disclaimer of opinion**

**Fixed assets**

5. For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the existence, rights, completeness and valuation of fixed assets to the value of R181 910 (credit) (2007: R181 910 (credit)), as disclosed in the balance sheet and the related detailed disclosure in note 6 to the financial statements:
  - The municipality did not maintain a reliable record of fixed assets that contained all relevant information for the proper identification of fixed assets costing R127 785 640. As a reliable record containing all relevant information of fixed assets was not

available, sufficient appropriate audit evidence as to the completeness of assets could not be obtained.

- Note 6 to the financial statements indicated that fixed assets had a negative value of R181 910 (2007: negative of R181 910) at year-end. As fixed assets cannot have a negative value, either loans redeemed and other capital receipts as disclosed in note 6 to the financial statements were overstated by at least R181 910 or fixed assets were understated by at least R181 910.
- Note 6 to the financial statements indicated that capital expenditure during the year was nil rand. Included in expenditure in the income statement was an amount of R17 072 698 with regard to contributions to capital expenditure. Consequently, due to an oversight by management, capital expenditure during the year and loans redeemed and other capital receipts as disclosed in note 6 to the financial statements were understated by at least R17 072 698.
- The cost of fixed assets according to the fixed asset register differed by R3 666 832 (2007: R3 666 832) from the total fixed assets disclosed in the financial statements, due to the fact that the asset register was not updated timeously during the current and previous financial years.
- Projects with a total cost of R24 921 994 (2007: R8 545 772) were completed during the year, but the completed projects could not be identified in the fixed asset register.
- Although assets with a value of R385 330 were transferred to the Free State Department of Health during a previous financial year, these assets were still included in the fixed asset register of the municipality.
- According to the municipality's accounting policy, fixed assets are stated either at historical cost or at valuation where assets have been acquired by grant or donation, while they are in existence and fit for use, except in the case of bulk assets that are written off at the end of their estimated life as determined by the treasurer. Contrary to the prescripts of the municipality's accounting policy, 555 assets (2007: 555 assets) were not disclosed at either cost price or valuation but were included in the asset records at a value between nil rand and R10, as the actual costs or fair value of the assets had not been determined. The value of fixed assets and loans redeemed and other capital receipts was therefore misstated by an unquantifiable amount that would equate to the cost or fair value of these assets had it been determined.
- During the physical verification of assets, damaged assets with a cost of R609 744 (2007: R436 362) were identified. No provision was made against loans redeemed and other capital receipts for the impairment of these assets.
- For contracts totalling R20 892 393 (2007: R21 347 293) the relevant contracts could not be submitted to obtain sufficient appropriate audit evidence as to the completeness, accuracy and occurrence of capital expenditure of R6 778 532 (2007: R9 007 138).
- Sufficient and appropriate supporting documentation could still not be obtained in respect of asset acquisitions of R1 807 356 in the previous financial year. Appropriate audit assurance was therefore not available to determine whether these transactions occurred and were accurately recorded and that irregular expenditure was not incurred.

Due to the extent of the weaknesses in the fixed asset records of the municipality and the lack of sufficient appropriate supporting documentation, I could also not perform reasonable alternative procedures to obtain all the documentation and explanations deemed necessary.

## Debtors

6. For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the existence, rights, completeness and valuation of debtors to the value of R2 192 269 (2007: R13 894 921), as disclosed in the balance sheet and the related detailed disclosure in note 10 to the financial statements:
- No supporting documentation could be submitted by management with regard to journals that impacted on debtors of R1 745 192 (2007: R5 614 182) and on the provision for doubtful debt of nil rand (2007: R4 508 809). I could therefore not determine whether these journals were valid and accurately recorded and could thus not gain adequate audit assurance as to the valuation and allocation of consumer debtors in the current and prior year and the provision for doubtful debt in the prior year. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these journals.
  - Included in the prior year consumer debtors balance as disclosed in note 10 to the financial statements was an account with a credit balance of R1 035 838, which represented receipts that were not allocated. As I could not obtain the documentation and explanations deemed necessary to classify the receipts, I could not determine whether the unallocated receipts amounting to R1 035 838 represented income or receipts from debtors. The municipality's records did not permit the performance of alternative audit procedures regarding these unallocated receipts. Consequently, I could not determine the amount by which payables and receivables were overstated and revenue was understated in the comparative figures.
  - Supporting documentation could not be submitted by management with regard to the difference of R1 846 441 (2007: R1 148 913) that existed between the debtors age analysis and the amount disclosed in note 10 to the financial statements with regard to consumer debtors. Consequently, I was not able to gain adequate audit assurance as to the completeness, existence and valuation of the consumer debtor accounts and whether the accounts represented rights of the municipality. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding the identified difference.
  - Management could not submit supporting documentation with regard to journals that had a credit impact on consumer debtor accounts of R2 347 730 and a debit impact on revenue and value-added tax (VAT) of R2 059 412 and R288 317, respectively, during July 2008. I could therefore not determine the reasons for the journals and whether the journals related to the year under review. Consequently, I was not able to gain adequate audit assurance as to the valuation and existence of the consumer debtor accounts as disclosed in note 10 to the financial statements and whether the accounts represented rights of the municipality. Furthermore, I was not able to gain adequate audit assurance with regard to the accuracy, occurrence and cut-off of revenue as disclosed in the income statement. The municipality's records did not permit the performance of reasonable alternative audit procedures regarding these journals.
  - Supporting documentation in respect of sundry debtor accounts with a total balance of R764 123 (2007: R2 056 197), included in debtors in note 10 to the financial statements, could not be submitted by management. Consequently, I was not able to obtain sufficient appropriate audit evidence as to the existence and valuation of these sundry debtor accounts and whether the accounts represented rights of the municipality. Due to the lack of sufficient appropriate audit evidence, I was unable to perform reasonable alternative audit procedures to provide me with the required audit assurance.

- Supporting documentation with regard to the line item "Error in Trial Balance" with a credit balance of R203 024 (2007: debit balance of R2 080 368), which was disclosed in note 10 to the financial statements, could not be submitted by management. The municipality's records did not permit the performance of alternative audit procedures regarding this balance. Consequently, I could not gain adequate audit assurance as to the existence, valuation, completeness and rights and obligations of this debtor account and I could not determine the effect of the error on the assets and liabilities as disclosed in the balance sheet and the income and expenditure as disclosed in the income statement.
  - An age analysis could not be submitted by management with regard to sundry debtors of R1 005 010 as disclosed in note 10 to the financial statements. Adequate supporting documentation was therefore not available to determine how long the sundry debtors had been outstanding. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation of the sundry debtors as disclosed in note 10 to the financial statements. The municipality's financial records did not allow the performance of reasonable alternative procedures.
7. Paragraph 77 of GA 100 *Framework for the preparation and presentation of financial statements by local government* (GA 100) states that an essential characteristic of a liability is that the local authority has a present obligation. Contrary to this requirement, debtors as disclosed in the balance sheet and in note 10 to the financial statements included consumer debtors with credit balances amounting to R4 071 163 (2007: R1 435 127) that should have been transferred to creditors. Consequently, due to an oversight by management, debtors and creditors were understated by R4 071 163 (2007: R1 435 127).
  8. Paragraph 52 of GA 100 states that to be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Contrary to this requirement, balances amounting to R608 869 (2007: R1 251 762) were included in other current debtors in note 10 to the financial statements. These balances related to consumer debtors and should have been included in consumer debtors in the same note to the financial statements. Consequently, due to an oversight by management, other current debtors were overstated by R608 869 (2007: R1 251 762) and consumer debtors were understated by the same amount.

### **Inventory**

9. Paragraph 68 of GA 100 states that an asset is a resource that is controlled by the local authority arising from past events, and from which future economic benefits are expected to flow to the local authority. Contrary to this requirement, a difference of R643 477 was noted between the total value of the inventory counted at year-end and the balance of R814 674 as disclosed in the balance sheet and note 9 to the financial statements in the prior year. Consequently, due to an oversight by management, inventory was overstated by R643 477 and expenses were understated by the same amount in the comparative figures.
10. The stock count sheets of the annual stock count could not be submitted by management. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights, completeness and existence of inventory of R734 711 as disclosed in note 9 to the financial statements. The municipality's records did not permit the performance of reasonable alternative audit procedures with regard to stock.

### **Investments**

11. In the prior year a difference of R328 829 was identified between third party confirmations and investments that were disclosed in the comparative figures in the balance sheet and note 7 to the financial statements. Because the relevant information was still not available, I

could not obtain adequate audit assurance as to the existence of the investment. The municipality's records did not permit the performance of alternative audit procedures. Consequently, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for investments.

12. Paragraph 52 of GA 100 states that to be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Contrary to this requirement, long-term investments as disclosed in the balance sheet and note 7 to the financial statements included an investment with a credit balance of R3 768 738. The confirmation that was received from the relevant bank indicated that the balance of the investment was R1 468 382 at year-end. Consequently, long-term investments was understated by R5 237 120 and bank was overstated by the same amount.
13. Contrary to the requirements on page 59 of the specimen published annual financial statements for local authorities (2nd edition) issued by the Institute of Municipal Finance Officers (IMFO), the market value of listed investments and the management valuation of investments were not disclosed in note 7 to the financial statements, due to an oversight by management. Because the relevant information was not available, I could not obtain adequate audit assurance as to management's valuation of investments. The municipality's records did not permit the performance of alternative audit procedures. Consequently, I was not able to determine management's valuation of investments.

#### **Bank**

14. A difference of R11 345 256 (2007: R399 782) was noted between the bank overdraft balance of R1 888 207 (2007: positive balance of R582 065) as disclosed in the balance sheet and note 12 to the financial statements, and the amount included as the cash book balance in the year-end bank reconciliation. Furthermore, supporting documents could not be submitted for journals with a total value of R37 230 981 (2007: R778 646), positive outstanding deposits of R6 850 146 and negative outstanding deposits of R2 632 011 that impacted on bank. Due to the lack of information, I was also unable to perform reasonable alternative audit procedures to provide me with the required audit assurance with regard to the bank balance. Consequently, I was unable to obtain sufficient appropriate audit evidence in respect of the valuation of the bank overdraft with a balance of R1 888 207 (2007: positive balance of R582 065) as disclosed in the balance sheet and note 12 to the financial statements.
15. Paragraph 52 of GA 100 states that to be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Contrary to this requirement, the year-end bank reconciliation included "Debit orders" of R4 982 087 that appeared on the bank statement and that had not been processed in the cash book. Consequently, due to an oversight by management, the bank overdraft as disclosed in the balance sheet and note 12 to the financial statements was understated by R4 982 087. Because the relevant information was not available, it was not possible to determine the impact on expenditure, assets, creditors and investments.
16. Section 125(2)(a) of the MFMA requires that the notes to the annual financial statements of a municipality must disclose in respect of each bank account held by the municipality during the relevant financial year the year opening balance and the year-end balances in each of the bank accounts. Contrary to this requirement, due to an oversight, management did not disclose the year opening of R1 053 098 and year-end bank balance of R711 626 in note 34 D to the financial statements.



17. In the previous year an audit trail for tracing individual receipts to the general ledger was lacking. This was due to the fact that receipts were only captured in the general ledger on a monthly basis through integration. Due to a lack of information and documents, I still could not determine whether receipts were captured accurately and completely. The municipality's records did not permit the performance of alternative audit procedures regarding the recording of receipts. Consequently, I was unable to obtain the required assurance as to the occurrence, completeness, allocation and accuracy of receipts to the amount of R117 357 697 in the prior year.

### **Provisions**

18. I was unable to obtain sufficient appropriate audit evidence in respect of the provision for accrued leave with a debit balance of R307 368 (2007: credit balance of R817 060) as disclosed in note 3 to the financial statements. Due to the lack of information, I was unable to perform reasonable alternative audit procedures to provide me with the required audit assurance. Consequently, I was not able to gain adequate audit assurance as to the existence, completeness, valuation and rights and obligations with regard to the provision for accrued leave.
19. In terms of paragraph 1.1 on page 62 of the specimen published annual financial statements for local authorities (2nd edition) issued by IMFO, provisions relate to liabilities, the amount of which cannot be determined with absolute certainty. Contrary to this requirement, due to an oversight by management, no provision was made for annual bonuses. Consequently, provisions as disclosed in the balance sheet and note 3 to the financial statements and expenditure as disclosed in the income statement were understated by R659 899.

### **Creditors**

20. For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the existence, obligation, completeness and valuation of creditors to the value of R35 964 959 (2007: R37 114 469), as disclosed in the balance sheet and the related detailed disclosure in note 11 to the financial statements:
- I was unable to obtain sufficient appropriate audit evidence in respect of trade creditors amounting to R14 674 769 (2007: R12 026 148) and sundry creditors amounting to R18 628 519 (2007: R10 958 966) that were included in trade creditors and sundry creditors disclosed in note 11 to the financial statements. Consequently, I was not able to gain adequate audit assurance as to the existence and valuation of these creditors and whether the creditors represented obligations of the municipality. Due to the lack of information, I was also unable to perform reasonable alternative audit procedures to provide me with the required audit assurance.
  - In the previous year an understatement of approximately R331 164 was identified regarding the VAT payable. Due to the fact that the relevant information was still not available, it was not possible to determine the other accounts and the amounts whereby they were overstated or understated. I was also unable to perform reasonable alternative audit procedures to provide me with the required audit assurance with regard to this matter.
  - Supporting documentation could not be submitted by management with regard to adjustments to VAT claimed to the value of R1 888 333. Consequently, I was not able to gain adequate audit assurance as to the valuation VAT with a total balance of R2 244 184 included in note 11 to the financial statements as part of sundry creditors. Due to the lack of information, I was also unable to perform reasonable alternative audit procedures to provide me with the required audit assurance.

- No supporting documentation could be obtained for journals that impacted on sundry creditors of R702 631 (2007: R1 224 876) and trade creditors of R38 981 (2007: R148 371). I could therefore not determine whether these journals were valid and accurately recorded and could thus not obtain adequate audit assurance as to the valuation and allocation of sundry creditors and trade creditors. The municipality's records did not permit the performance of alternative audit procedures regarding these journals.
21. Section 20 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) (VAT Act) sets out the requirements of a valid tax invoice. The municipality has to be in possession of a valid tax invoice before input VAT can be claimed on a payment. However, input VAT of R764 351 was claimed on payments for which a valid tax invoice was not available. Consequently, due to an oversight by management, assets were understated by R738 052 and expenditure was understated by R26 299, while the VAT liability included in sundry creditors in note 11 to the financial statements was understated by R764 351.
  22. Due to an allocation error that was made during the processing of payments in the previous year, an amount of R345 851 was included in trade creditors in the previous year with regard to trade creditors that had already been paid during that year. Consequently, prior year trade creditors as disclosed in note 11 to the financial statements and prior year expenses were overstated by R345 851. Furthermore, the error was corrected in the current financial year with the result that expenditure was understated by R345 851 in the current year and the accumulated deficit at the beginning of the year was overstated by the same amount.
  23. In a previous year a cancelled cheque was reversed against trade creditors, and not other creditors due to an allocation error when cancelled cheques were processed. No correcting entry was made in the current financial year. Consequently, other creditors were still understated and trade creditors were still overstated by R338 365.
  24. Paragraph 68 of GA 100 states that a liability is a present obligation of the local authority arising from past events, the settlement of which is expected to result in an outflow from the local authority of resources embodying economic benefits. Contrary to this requirement, outstanding audit fees amounting to R1 322 502 were not included in sundry creditors as an accrual. Consequently, due to an oversight by management, sundry creditors included in note 11 to the financial statements and the related expense were understated by R1 322 502.

#### **Statutory funds**

25. Although the municipality requested exemption from making contributions to the capital development fund in terms of section 82(1) of the Local Government Ordinance, 1962 (Ord. No. 8 of 1962), proof that the exemption was granted could not be submitted. Consequently, the capital development fund as disclosed in note 1 to the financial statements was understated and the retained surplus overstated by R3 640 421 (2007: R3 110 249), due to the fact that no contributions had been made by management since the 30 June 2002 financial year.
26. Section 84(2) of the Local Government Ordinance, 1962 (Ord. No. 8 of 1962) states that the interest from investments shall be credited to the relative trust or other fund, provided that in the case of the erven trust fund not less than 50% of the interest shall be credited to the fund and the rest to revenue and that interest earned by a capital reserve fund may be credited to revenue. Contrary to the above, interest earned was not transferred to the relevant funds. Consequently, due to an oversight by management, interest received as included in income was overstated by R625 844 and statutory funds as disclosed in note 1 to the financial statements and the balance sheet were understated by the same amount.

## Income

27. Adequate audit assurance could not be obtained as to the completeness and accuracy of assessment rates revenue amounting to R4 768 863 (2007: R3 242 189) disclosed in note 13 to the financial statements and the valuation and completeness of the related debtors accounts disclosed in note 10 to the financial statements, due to an assessment rates reconciliation that was performed based on the information included in the valuation roll that indicated a difference of R445 650 for the current financial year. No explanations or supporting documentation could be submitted by management to explain the difference. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts disclosed in the financial statements for debtors, revenue, deficit for the year and accumulated deficit. In the absence of sufficient appropriate evidence, I was also not able to perform reasonable alternative procedures to obtain the required audit assurance in this regard.
28. Adequate audit assurance could not be obtained as to the occurrence, completeness and accuracy of the sale of water and electricity amounting to R12 523 044 and a debit of R1 085 971 as disclosed in the income statement and the valuation and completeness of the related debtors accounts disclosed in note 10 to the financial statements, due to the following:
- Meter readings with regard to water and electricity usage from December 2007 to May 2008 could not be submitted by management, because the system on which the readings were recorded crashed and the information was lost. Furthermore, the meter reading cards that were used in June 2008 could not be submitted by management.
  - Water and electricity meter readings were not transferred accurately from the system on which the meter readings were captured to the billing system.
  - Water revenue had a debit balance of R1 085 971. Water revenue should have a credit balance. No supporting documentation could be submitted to explain why water revenue had a debit balance.
- Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts disclosed in the financial statements for debtors, trading services revenue, deficit for the year and accumulated deficit. In the absence of sufficient appropriate evidence, I was also not able to perform reasonable alternative procedures to obtain the required audit assurance in this regard.
29. No supporting documentation could be submitted by management with regard to income transactions amounting to R814 695 (2007: R304 430) included in community services income in the income statement. Accordingly, I could not obtain sufficient appropriate audit evidence with regard to the occurrence, completeness and accuracy of the amounts disclosed in the financial statements for community services income and the valuation of debtors, deficit for the year and accumulated deficit. In the absence of sufficient appropriate evidence, I was also not able to perform reasonable alternative procedures to obtain the required audit assurance in this regard.
30. No supporting documentation could be submitted by management with regard to rental income transactions amounting to R194 242 included in economic services income in the income statement. Accordingly, I could not obtain sufficient appropriate audit evidence with regard to the occurrence, completeness and accuracy of the amounts disclosed in the financial statements for community services income and the valuation of debtors, deficit for the year and accumulated deficit. In the absence of sufficient appropriate evidence, I was also not able to perform reasonable alternative procedures to obtain the required audit assurance in this regard.



31. No supporting documentation could be submitted by management for journals that impacted on revenue of R781 928 (2007: R1 149 809). I could therefore not determine whether these journals were valid and accurately recorded and could thus not gain adequate audit assurance as to the accuracy and allocation of revenue. The municipality's records did not permit the performance of alternative audit procedures regarding these journals.
32. Expenses that related to grants were incorrectly allocated to income. The expenses should have been allocated to sundry creditors. Consequently, income from economic services and trading services as disclosed in the income statement was understated by R1 444 533 and R397 586, respectively, and sundry creditors as disclosed in note 11 to the financial statements were overstated by R1 842 119.
33. Included in the actual expenditure for economic services in the previous year was an amount of R1 761 752 with regard to free basic water and electricity. The expense was created by crediting an income account and debiting the expenditure account. This had the effect that the prior year actual expenditure and prior year actual income from economic services as disclosed in the income statement were overstated by R1 761 752.
34. In the prior year the equitable share was reallocated to the different services. Consequently, the prior year revenue for community services as disclosed in the income statement was understated by R3 190 256. The prior year revenue as disclosed in the income statement for subsidised services, economic services and trading services was overstated by R259 044, R750 364 and R2 180 848, respectively.
35. During the prior year an incorrect journal was processed to reverse an incorrect service charge. The correction was incorrectly processed by debiting bad debts and crediting water service charges. The matter was not corrected during the current year. Consequently, the prior year revenue for trading services disclosed in the income statement and prior and current year debtors disclosed in the balance sheet were overstated by R594 062, resulting in the understatement of the prior year deficit for the year and the current year accumulated deficit by the said amount.

### **Expenditure**

36. The relevant contracts for payments totalling R532 684 (2007: R1 110 278) in respect of operating expenditure were not submitted by management. In addition, the relevant supporting documentation could not be submitted for payments totalling R1 993 011 (2007: R1 142 086). I could therefore not determine whether these payments were accurately recorded and could thus not gain adequate audit assurance as to the accuracy, occurrence and allocation of expenditure and that irregular expenditure was not incurred. The municipality's records did not permit the performance of alternative audit procedures regarding these payments.
37. No supporting documentation could be submitted by management for journals that impacted on expenditure of R45 632 (2007: R22 952 361). I could therefore not determine whether these journals were valid and accurately recorded and could thus not gain adequate audit assurance as to the accuracy and allocation of expenditure. The municipality's records did not permit the performance of alternative audit procedures regarding these journals.
38. Due to the fact that the municipality incorrectly provided for audit fees in the year before the previous financial year, the previous year's expenditure of R76 706 737 as disclosed in the income statement was understated by R693 918 and the accumulated surplus at the beginning of the previous year was understated by R693 918.
39. No supporting documentation could be submitted by management with regard to expenditure amounting to R987 663, to substantiate that the relevant goods were received or the services were rendered. I could therefore not gain adequate audit assurance as to the

occurrence of these expenditure transactions. The municipality's records did not permit the performance of alternative audit procedures regarding these payments.

40. A payment of R1 092 809 was not processed in the general ledger. Consequently, expenditure as disclosed in the income statement was understated by R958 605, VAT included in sundry creditors in note 11 to the financial statements was overstated by R134 204 and the bank overdraft as disclosed in the balance sheet and note 12 to the financial statements was understated by R1 092 809.
41. The municipality did not reconcile the salary system with the general ledger during the year under review. The reconciliation of the total of the salary integration journals processed in the general ledger and the total salaries according to the salary system indicated a difference of R4 424 665 (2007: R1 599 192). The difference related to certain salary integration journals that were processed twice during the year. Furthermore, wage payments amounting to R638 767 and skills development levy payments amounting to R224 212 were debited against the salary control account and not the salary expense account. Consequently, due to an oversight by management, the salary expense included in expenditure was overstated by R3 561 686 and sundry debtors included in note 10 to the financial statements were understated by the same amount.
42. Due to a calculation error, the salary information disclosed in terms of section 124(1)(c) of the MFMA in notes 14 and 16 to the financial statements was understated by R310 622 and R133 190, respectively (2007: note 16 overstated by R314 499), when compared to the salary information on the salary system.
43. In the previous financial year supporting documentation for the monthly salaries and benefits payable to a number of employees could not be obtained in the respective personnel files. The municipality's records did not permit the performance of alternative audit procedures with regard to these salaries. I was still not able to obtain adequate assurance regarding the accuracy and occurrence of salaries of the prior year amounting to R2 300 622.

#### **Cash flow statement**

44. I was not able to determine whether the cash flow statement and the related notes were fairly stated, due to the material effect on the cash flow statement and related notes of scope limitations and identified misstatements as reported in this report.

#### **Capital commitments**

45. I was unable to obtain sufficient appropriate audit evidence to provide me with audit assurance as to the completeness and valuation of the capital commitments of nil rand (2007: nil rand) as disclosed in note 32 to the financial statements. Council minutes of 4 June 2008 included approval for capital projects amounting to at least R3 242 517. The municipality's records did not permit the performance of alternative audit procedures to obtain adequate audit assurance on the disclosed value of capital commitments.
46. Furthermore, the capital commitments disclosed in note 32 to the financial statements were not complete, as the following information required by the applicable basis of accounting was not disclosed:
  - (i) Commitments in respect of capital expenditure:
    - Approved and contracted for
    - Approved but not yet contracted for
  - (ii) Funding of capital commitments

### **Incomplete and incorrect disclosures in the financial statements**

47. An amount of R20 559 489 was disclosed in the comparative figures of note 23 to the financial statements as a prior year adjustment. Contrary to the applicable basis of accounting, details had still not been disclosed with regard to the nature and reason for the adjustments. The contributions made from the operating account as required by the applicable basis of accounting were also not disclosed in the comparative figures of note 23 to the financial statements.
48. I was also unable to obtain sufficient appropriate audit evidence as to the completeness and accuracy of the valuation of all the properties in the municipal area disclosed in note 13 to the financial statements as R365 232 647. In the absence of sufficient appropriate evidence, I was also not able to perform reasonable alternative procedures to obtain the required audit assurance in this regard.
49. The actuarial valuations of the different pension funds towards which the council made contributions as well as the contributions that were made to these pension funds were not disclosed in the financial statements as required by the applicable basis of accounting.
50. The total amounts paid in audit fees, taxes, levies, duties as well as pension and medical aid contributions, whether any amounts were outstanding at the end of the financial year as well as contributions to organised local government were not disclosed in the financial statements as required in terms of section 125 of the MFMA.
51. All instances of non-compliance with the MFMA were not disclosed in the notes to the financial statements as required in terms of section 125(2)(e) of the MFMA.
52. Contrary to section 123(1) of the MFMA, the following were not disclosed in the notes to the financial statements with regard to grants and subsidies received:
  - All allocations received from the national and provincial sphere of government.
  - How the allocations were spent.
  - If the municipality complied with the conditions and, if not, the reasons for non-compliance.
  - Whether any funds were delayed or withheld.

### **Budgeted amounts**

53. The approved adjustments budget could not be submitted by management. The entity's records did not permit the application of alternative audit procedures regarding the budget information disclosed in the income statement. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the accuracy and completeness of the amounts disclosed in the income statement with regard to budget information.

### **Irregular expenditure**

54. Irregular expenditure of R8 592 720 (2007: R1 800 928) was incurred by the municipality due to a combination of the following:
  - The number of quotations as required by paragraph 12 of the Local Government: Municipal Supply Chain Management Regulations, 2001 (supply chain management regulations) was not obtained.
  - Payments were not approved by a delegated official as required by paragraph 11 of the supply chain management regulations.
  - Bids were not invited for expenditure in excess of R200 000 as required by paragraph 12 of the supply chain management regulations.
  - Tax certificates with regard to the relevant suppliers were not obtained as required by paragraph 13 of the supply chain management regulations.

- No proof that an advertisement was placed with regard to procurement in excess of R200 000 could be submitted as required by paragraph 22 of the supply chain management regulations.

Furthermore, the amount was not disclosed in the financial statements as irregular expenditure as required in terms of section 125 of the MFMA.

55. In the prior year, payments totalling R98 340 were made in contravention of the Remuneration of Public Office Bearers Act, 1998 (Act No. 20 of 1998). These payments were not regarded as irregular expenditure as required in terms of section 167(2) of the MFMA and were still not disclosed in the financial statements as required by section 125(2)(d) of the MFMA.

### **Unauthorised expenditure**

56. The approved adjustments budget could not be submitted by management. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the unauthorised expenditure of nil rand as disclosed in note 34 E to the financial statements. The entity's records did not permit the application of alternative audit procedures regarding unauthorised expenditure.
57. During the previous financial year a financial management grant was utilised for expenditure amounting to R198 525, which was not in accordance with the purpose of the grant. In terms of section 1 of the MFMA, this constitutes unauthorised expenditure. This unauthorised expenditure was still not disclosed in the prior year amounts in the financial statements as required in terms of section 125 of the MFMA.

### **Going concern**

58. As disclosed in the balance sheet, the municipality was in a net liability position of R40 657 797 (2007: R14 580 579). Furthermore, the municipality had unfunded reserves at year-end of R14 999 007. The difficulties experienced by the municipality in recovering all debts due to it as well as the potential negative effect of this tendency on the cash flows of the municipality indicated that there was a risk that the municipality might be exposed to serious financial problems, which might require provincial or national intervention arising from financial crises as set out in terms of sections 139 and 150 of the MFMA. This matter was not adequately disclosed in the financial statements.

### **Disclaimer of opinion**

59. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Mafube Local Municipality. Accordingly, I do not express an opinion on the financial statements.

### **EMPHASIS OF MATTER**

I draw attention to the following matters:

#### **Material inconsistencies in information included in the annual report**

60. Assessment rates for the 2007 year disclosed in note 13 amounted to R4 534 829, while appendix D to the financial statements disclosed assessment rates as R 3 242 189. The difference amounted to R1 292 640.

## OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

### Internal controls

61. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for disclaimer of opinion</b>					
Fixed assets	X		X		X
Debtors			X		X
Inventory			X		
Investments			X		X
Bank			X		
Provisions			X		
Creditors			X		X
Statutory funds			X		X
Income			X		X
Expenditure			X		X
Cash flow statement			X		
Capital commitments			X		X
Incomplete and incorrect disclosures in the financial statements			X		
Budgeted amounts			X		
Irregular expenditure		X	X		
Unauthorised expenditure			X		
Going concern	X		X		
Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.					
Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.					
Control activities: policies, procedures and practices that ensure that management's					



financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

## **Material non-compliance with applicable legislation**

### **Municipal Finance Management Act**

62. In terms of section 65(2)(e) of the MFMA, the accounting officer of a municipality must ensure that all money owing by the municipality is paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise for certain categories of expenditure. In respect of several payments with a total value of R304 519 (2007: R4 883 199), I was unable to obtain sufficient appropriate audit evidence that the payment was made within the prescribed period.
63. Section 71 of the MFMA states that the accounting officer of a municipality must by no later than 10 working days after the end of each month submit to the mayor of the municipality and the relevant provincial treasury a statement on the state of the municipality's budget. No supporting documentation could be submitted to indicate that statements were submitted to the provincial treasury.
64. Section 64(3) of the MFMA states that the accounting officer of a municipality must immediately inform the National Treasury of any payments due by an organ of state to the municipality in respect of municipal tax or for municipal services, if such payments are regularly in arrears for periods of more than 30 days. Contrary to the above, no proof could be submitted by management that the National Treasury was informed of long-outstanding debt, although government balances amounting to R1 091 978 were outstanding for more than 30 days.
65. Section 72(1) of the MFMA states that the accounting officer of a municipality must by 25 January of each year assess the performance of the municipality during the first half of the financial year and submit a report on such assessment to the mayor of the municipality, the National Treasury and the relevant provincial treasury. No proof could be submitted that such an assessment was performed.
66. Section 74(2) of the MFMA states that if the accounting officer of a municipality is unable to comply with any of the responsibilities in terms of the MFMA, he/she must promptly report the inability, together with reasons, to the mayor and the provincial treasury. Several instances were noted where the required reports were not submitted to the provincial treasury. However, no proof could be submitted that this matter was reported to the provincial treasury, explaining the reason why the reports were not submitted.
67. In terms of section 121 of the MFMA, the municipality has to prepare an annual report for each financial year. No annual reports were compiled and submitted for the 2005-06, 2006-07 and 2007-08 financial years.

68. Section 122(1)(a) of the MFMA requires every municipality to prepare financial statements that fairly present the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results and its financial position as at the end of the financial year. However, the financial statements submitted to the Auditor-General on 9 February 2009 for the 2007-08 financial year contained a number of material errors as set out in this report.

#### **Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)**

69. Declaration forms signed by the councillors to disclose any direct or indirect personal or private business interest which that councillor, or any spouse, partner or business associate of that councillor, may have in any matter while serving before the council was not submitted for six councillors, as required by items 7(1) and 5(1)(a) of the code of conduct for councillors set out in schedule 1 of the MSA.
70. Contrary to section 57(1) and (2) of the MSA, there were no written and signed annual performance agreements in place for the municipal manager and the managers directly accountable to him for the 2007-08 financial year.

#### **Matters of governance**

71. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.		X
• The internal audit function operates in terms of an approved internal audit plan.		X
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
<b>Other matters of governance</b>		
The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.		X
The financial statements submitted for auditing were not subject to any material amendments resulting from the audit.	X	
No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
The prior year's external audit recommendations have been substantially implemented.		X
SCOPA resolutions have been substantially implemented.		X

### **Unaudited supplementary schedules**

72. The supplementary information set out on pages [XX] to [XX] does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.

### **OTHER REPORTING RESPONSIBILITIES**

#### **REPORT ON PERFORMANCE INFORMATION**

73. I was engaged to review the performance information.

#### **Responsibility of the accounting officer for the performance information**

74. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

#### **Responsibility of the Auditor-General**

75. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
76. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
77. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

#### **Audit findings (performance information)**

##### **Non-compliance with regulatory requirements**

##### **No performance management system in place**

78. The municipality did not develop and implement a performance management system as required in terms of sections 38 to 42 of the MSA.
79. Section 69(3) of the MFMA requires that the accounting officer must by no later than 14 days after the approval of an annual budget submit to the mayor a draft service delivery and budget implementation plan for the budget year. Contrary to the above, the service delivery and budget implementation plan for 2007-08 could not be submitted. I could therefore not determine whether the municipality had complied with this requirement of the MFMA.

##### **No quarterly reporting on performance information**

80. Due to a lack of a performance management system, no quarterly reports on the progress in achieving measurable objectives and targets were prepared as a whole for the municipality, to facilitate effective performance monitoring, evaluation and corrective action as required by section 40 of the MSA.

##### **Existence and functioning of a performance audit committee**

81. The municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee as required by

regulation 14(2)(a) of the Local Government Municipal Planning and Performance Management Regulations, 2001.

**Internal auditing of performance measurements**

82. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA and section 165(2)(b)(v) of the MFMA.

**Mid-year performance assessment not performed**

83. A report by the accounting officer could not be submitted on mid-year budget and performance assessments as required by section 72 of the MFMA.

**Performance information not received in time**

84. Contrary to the requirements of section 121(3)(c) of the MFMA, the municipality did not submit the annual performance report prepared by the municipality in terms of section 46 of the MSA for evaluation as part of the audit process.

**APPRECIATION**

85. The assistance rendered by the staff of the municipality during the audit is sincerely appreciated.

*Auditor-General*  
Bloemfontein

8 May 2009



AUDITOR - GENERAL  
SOUTH AFRICA